CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORE OFFICE REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous core office real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Core Office Real Estate Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest risk-adjusted total rate of return possible is the strategic objective of the Portfolio. This objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Core Office Real Estate Portfolio shall be managed to accomplish the following:

A. Provide diversification;

B. Preserve investment capital;

C. Generate attractive risk-adjusted rates of return for the System;

D. Provide a hedge against inflation;

E. Provide stable cash flow from operations;

F. Provide appreciation potential; and

G. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

A. Exceed (after fees) a minimum target real rate of return of 5.0%; and

B. Exceed (before fees) the National Council of Real Estate Investment Fiduciaries Index ("the NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

Subject to the Statement of Investment Policy for Equity Real Estate, the following is the current asset allocation range for the Core Office Real Estate Portfolio as percent of the total Equity Real Estate Portfolio:

	Range
Core Office Real Estate Portfolio:	10-35%

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable time frame.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Diversification

The Portfolio shall reduce risk through appropriate diversification. Diversification shall occur primarily by geography and investment strategy, as outlined below.

1. Diversification by Geography

The Portfolio shall be comprised primarily of investments in the United States. The Portfolio shall contribute to the overall geographic diversification objectives of the Core Real Estate Portfolio as specified in the Statement of Investment Policy for Equity Real Estate.

2. Diversification by Strategy

The System shall employ a broad range of strategies for office property investments. The allocation ranges established for each of the recommended strategies are a percentage of the Core Office Real Estate Portfolio and listed below. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Existing Office Properties	60 - 100%
Existing Value Added Office Properties	0 - 15%
Build-to-Suit Office Development	0 - 15%
Speculative Office Development	0 - 10%
Land	0 - 5%

The Senior Investment Officer of Real Estate may allow a specific core property sector to exceed the 10% Speculative Development level as long as the **overall** Core Portfolio Speculative Development level **does not** exceed 10%.

3. From time to time, the actual allocations of various geographic sectors and investment strategies may fall out of the ranges prescribed by the Policy. In these instances, the System shall implement adjustments correcting the actual allocations so they comply with the Policy allocation ranges, within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the investment returns for the System, is considered a reasonable time frame.

B. Investment Objectives and Criteria

1. Existing Office Properties

a. Investment objective is to generate cash flow returns with appreciation potential.

b. Investment Criteria

(1) Suburban and Central Business District (CBD) locations;

(2) Minimum investment size of $10 million;

(3) Minimum occupancy - 75% upon acquisition and projected to average 75% during first three years of ownership;

(4) Building age of 20 years or less from original construction or renovation, unless the property achieves rents comparable to buildings no more than 15 years old;

(5) Institutional grade property;

(6) Each property shall produce a minimum five-year real IRR (after fees) of 5%;

(7) Each property shall produce an appropriate risk adjusted return; and

(8) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

2. Existing Value-Added Office Properties

a. "Value-added" shall refer to existing properties, acquired by the System with the intention of redeveloping, re-leasing, or repositioning the properties in some manner so as to yield higher total returns. A value-added office project can be an office property that, at acquisition, is less than 75% leased or projected to be less than 75% leased during the first three years of ownership.

A value-added office project can also be any office project, including existing office, with redevelopment or repositioning budget equal to 20% or more of the Fair Market Value of the property. This excludes land if the project has been held for one year or more, or the cost of investment, excluding land for projects held less than one year.

(1) Reclassification to build-to-suit shall occur when a value- added project is 75% leased for a minimum of five years and 75% of the value-added redevelopment work has been completed (excluding tenant improvements and leasing commissions).

(2) Reclassification to existing office shall occur once a Certificate of Occupancy for the base building and all occupied floors has been obtained, the project is 90% leased, and 90% of the value-added redevelopment work has

been completed (excluding tenant improvements and leasing commissions).

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) Suburban and Central Business District (CBD) locations;

(2) Institutional grade property;

(3) Each property shall produce a minimum five-year real IRR (after fees) of 6.50%;

(4) Each property shall produce an appropriate risk adjusted return; and

(5) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

3. Build-to-Suit Office Development

a. "Build-to-Suit Development" shall refer to a to-be-built office development that is at least 75% pre-leased with a weighted average lease term of at least five years upon commencement of construction.

Reclassification to an existing office project shall occur when a Certificate of Occupancy for the building has been obtained and the project is 90% leased with a weighted average lease term of at least four years.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 75% pre-leasing occupancy;

(2) Suburban and Central Business District (CBD) locations;

(3) Institutional grade property;

(4) Each property shall produce a minimum five-year real internal rate of return ("IRR") (after fees) of 5.75%;

(5) Each property shall produce an appropriate risk adjusted return; and

(6) Additionally, development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Real Estate Development and the Statement of Investment Policy for Real Estate Equity Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) Investment manager shall control design, amenities, costs and overall quality of construction projects.

4. Speculative Office Development

a. “Speculative office development” shall refer to the construction of an office building leased to one or more tenants with less than 75% pre-leasing or a weighted average lease term of less than five years.

(1) Reclassification to build-to-suit will occur when the project is almost 75% leased with a weighted average lease term of five years and 75% of the original development work (excluding tenant improvements and leasing commissions) for the project is complete.

(2) Reclassification to existing office will occur once a Certificate of Occupancy for the base building and all occupied floors has been obtained and the project is 90% leased with a weighted average lease term of four years.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) No minimum occupancy;

(2) Suburban and Central Business District (CBD) locations;

(3) Institutional grade property;

(4) A speculative office development project, original build-to-suit office, or value-added office properties shall be reclassified as existing office once the project meets the following criteria:

(a) 90% leased for an average lease term of a minimum of four years;

(b) A Certificate of Occupancy for the base building and all occupied floors; and

(c) 90% of the value-added redevelopment work has been is complete, excluding tenant improvements and leasing commissions (applies to value-added only)

(5) Each property shall produce a minimum five-year real IRR (after fees) of 7.0%;

(6) Each property shall produce an appropriate risk adjusted return; and

(7) Additionally, development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Real Estate Development and the Statement of Investment Policy for Real Estate Equity Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) Investment manager shall control design, amenities, costs and overall quality of construction projects.

5. Land

a. “Land” shall refer to undeveloped, vacant land intended for office building development and ancillary related uses (e.g. restaurants).

b. Investment objective is to acquire land intended for development of office properties.

c. Investment Criteria

(1) Locations will be selected from supply-constrained markets and strategic in-fill locations within the sub-markets of existing assets accommodating growth;

(2) Entitlements are defined as land acquisitions that meet the following criteria:

(a) Zoned for office development;

(b) Free of governmental restrictions to office development (including, but not limited to, no-growth initiatives, building moratoriums and conflicts with general plan amendments); and

(c) Reasonably expected to receive site plan approval in the ordinary course of business.

(3) Environmental compliance is met when a satisfactory Phase I environmental report completed prior to land acquisition;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 8.0%; and

(5) Each property shall produce an appropriate risk adjusted return.

VI. GENERAL

A. Terms in this policy are defined in a master glossary of terms.

B. Unless otherwise noted, investors, managers, consultants, partners members, or other participants selected by the System shall base all calculations and computations on Fair Market Value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation for accounting purposes. See Statement of Investment Policy for Equity Real Estate Appraisal and Valuation Policy.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms is referenced in the System's Master Glossary of Terms.